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FILED
APR 9 1997
CLERK

No. 96-1236

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1996

KRYGOSKI CONSTRUCTION COMPANY, INC.,
Petitioner,
v.
UNITED STATES OF AMERICA,
Respondent.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Federal Circuit

BRIEF AMICUS CURIAE OF THE WASHINGTON LEGAL FOUNDATION IN SUPPORT OF PETITIONER

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Date: April 9, 1997

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BRIEF AMICUS CURIAE OF THE WASHINGTON LEGAL FOUNDATION IN SUPPORT OF PETITIONER

The Washington Legal Foundation ("WLF") respectfully submits this brief as amicus curiae in support of the petitioner, Krygoski Construction Company, Inc. ("Krygoski").

INTEREST OF AMICUS CURIAE

WLF is a non-profit public interest law and policy center based in Washington, D.C., with supporters nationwide. WLF believes it is in the public interest to hold the federal government and its agencies accountable for their conduct, including their contractual dealings with the private sector.

WLF takes issue with the Government's position that the Government may, in the absence of changed circumstances, exercise the standard termination for convenience clause found in government contracts to

escape breach of contract damages. The Government's view of its contractual obligations would permit the United States to breach its contracts, denying to contractors the benefit of their bargains, without having to pay for the consequences of its breach, thereby holding the United States to a lesser standard of accountability than private parties. This position is contrary to law and will likely affect the future willingness of private businesses to contract with the Government. WLF believes it is in the public interest for the Court to recognize the significance of this issue to the broad business community as well as to society at large.[1]

WLF has appeared as amicus in numerous cases before this Court, including those that raise the issue of the extent to which the Government should be held accountable for its breaches of contractual obligations. *See, e.g., Wells Fargo Bank, N.A. v. United States*, No. 96-928, *cert. denied*, 1996 WL 723422 (Mar. 17, 1997).

STATEMENT OF THE CASE

Krygoski was the successful low bidder for a government contract that called for the demolition and removal of the structures at an old government missile facility. The contract also included the abatement of asbestos at the site. Because the Government did not determine the exact extent of the asbestos contamination prior to issuing the invitation for bids, the invitation provided only an estimate of the amount of asbestos that would need to be removed. The contract as issued provided rates for the removal of the estimated amount of asbestos as well as rates for amounts in excess of the estimates.

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[1] Petitioner and the United States have consented to the filing of this brief. Their respective letters of consent are filed herewith.

Following the award of the contract, Krygoski discovered that the actual amount of asbestos was higher than the estimate provided by the Government. The Government failed to conduct the joint inspection required by the contract, but acknowledged that the removal of the additional asbestos was encompassed by the terms of the contract. However, before Krygoski could begin the demolition process, the government contracting officer terminated the contract for the convenience of the government, citing an unwritten "rule of thumb" that required the automatic termination of any contract which required a net increase in cost of more than twenty-five to thirty percent.

REASONS FOR GRANTING THE WRIT

A. The Panel Decision Calls into Question the Enforceability of Government Contracts

The reasoning of the Federal Circuit panel below, if permitted to stand, will have serious and detrimental effects on the contracting process. In *Torncello v. United States*, 681 F.2d 756 (Cl. Ct. 1982) (en banc), the plurality decision clearly explained why the use of the standard government termination for convenience clause had to be limited to situations in which the circumstances or expectations of the parties surrounding the contract had changed. As explained in the briefs of petitioner and the other amici curiae, the Court of Appeals, by abandoning the changed circumstances test of *Torncello*, has called into question the enforceability of government contracts. If the panel decision in this case remains in effect and the relevant case law is not clarified, then government contractors and the Government must continue to question whether their contracts are supported by consideration.

The confusion surrounding the consideration issue may prove detrimental to the Government in subsequent contract disputes. If a contract is unenforceable for lack

of consideration, then that unenforceability extends both to the contractor *and* to the Government. Consequently, when faced with the prospect of losing money on a contract, a contractor may well stop work and, should the Government seek damages for breach of contract, raise the defense that the contract is unenforceable for lack of consideration.

B. The Panel Decision Fails to Resolve the Confused State of the Law Surrounding What Government Conduct Rises to the Level of Bad Faith

The petition in this matter raises as an included issue the appropriate definition and application of bad faith and abuse of discretion. Petition of Krygoski Construction Company, Inc. ("Petition") at 9 n.3. Even if the requirement that the Government refrain from acting in bad faith is sufficient to render the Government's promise non-illusory, the confused state of the law regarding what constitutes "bad faith" makes a reasoned prediction of what government action rises to the level of bad faith extremely difficult. *See* Petition at 9g (reprinting John Cibinic, Jr., *Convenience Terminations: What are the Limits?*, 10 NASH & CIBINIC REP. 147 (1996)).

Should the Court determine that a prohibition against bad faith or abuse of discretion provides the necessary consideration to render the contract enforceable, it should then define the scope of those concepts. We believe that the Federal Circuit failed to adequately address this subject and that its support for the contracting officer's application of a rule of thumb is contrary to law. The rule of thumb upon which the contracting officer relied was correctly found by the Court of Federal Claims to have no basis in law or regulation and should not be considered a basis for a finding that the contracting officer did not act in bad faith or abuse his discretion.

The unsettled state of the law was acknowledged and discussed at length by the trial court. *See* Petition at 37b-42b. The trial court analyzed three different definitions of bad faith: bad faith by specific intent to injure, bad faith by fraud, and bad faith by abuse of discretion. *See* Petition at 38b. Ultimately, the trial court settled on a definition encompassing the abuse of discretion standard. *See* Petition at 42b. The Court of Appeals applied the tests of bad faith and abuse of discretion, but failed to clarify the true contours of these standards. *See* Petition at 7a-8a. Consequently, confusion still reigns with respect to the scope of the bad faith doctrine.

C. The Contracting Officer's Reliance on an Unwritten "Rule of Thumb" That Triggers Contract Termination by the Government Is Itself an Abuse of Discretion and Constitutes Bad Faith

In reaching his decision to terminate the contract, the contracting officer relied on an unwritten rule of thumb that "required the automatic termination for convenience of any contract which required a net increase in cost of twenty-five to thirty percent, regardless of whether or not the increase was considered within the scope of the contract." *See* Petition at 11b. At the same time, the contracting officer acknowledged that the original contract had contemplated the complete removal of asbestos at the demolition site. Petition at 27b n.24. The trial court, noting that the contracting officer had provided no basis for his rule of thumb, and recognizing that the actual cost increase was ultimately *less* than this rule of thumb, held that the contracting officer abused his discretion and acted in bad faith in terminating the contract.

By reversing the trial court, the Court of Appeals accepted the contracting officer's unwritten rule of thumb, stating that in a termination for convenience, the

Court of Appeals would be "lenient." In accepting the rule of thumb, the panel without reference or citation ignored the decision of the Federal Circuit in *NI Industries, Inc. v. United States*, 841 F.2d 1104 (Fed. Cir. 1988). In *NI*, a contracting officer had denied a claim based upon a written but unpublished standard operating procedure. The Federal Circuit rejected the use of such a procedure, holding that the agency was without power to adopt and rely on such secret law, which affected all contractors, without publishing such a rule as regulation. *Id.* at 1107-08. Reliance on such an unpublished rule is illegal and represents an abuse of discretion. *Id.* at 1108.

In this case, the so-called "rule of thumb" relied upon by the contracting officer is not only unpublished, it is unwritten as well. Applying the reasoning of the *NI* decision to this case, the Federal Circuit should have found that reliance upon such an unwritten, unpublished rule of thumb (assuming such a rule exists) is an abuse of discretion and constitutes bad faith on the part of the contracting officer. There is simply no basis in the law for the "leniency" that the Court of Appeals used in this case. By failing to recognize this principle, the Court of Appeals raises considerable confusion surrounding the use of such unpublished rules of thumb.

D. The Rule of Thumb Has No Basis in Law or Regulation

As stated above, the Corps of Engineers and the contracting officer were without power to adopt an unpublished, unwritten rule of thumb affecting all contractors. Furthermore, the rule of thumb described is contrary to established law and regulations. As the trial judge stated, "the [contracting officer] cited no authority for his definition of cardinal change and . . . defendant's counsel was also unable to produce documentation for its witness' cardinal change theories." Petition at 44b.

The trial judge was unable to reconcile this rule of thumb with the case law regarding cardinal changes:

> Moreover, while no finite amount defines the scope of a cardinal change, the boundaries seem enormous. *Compare General Dynamics Corp. v. United States*, 218 Ct. Cl. 40, 56-57, 585 F.2d 457, 466 (1978) (finding a $100 million increase in a $60 million contract as within the scope of the contract) *with Peter Kiewit Sons' Co. v. Summit Constr. Co.*, 422 F.2d 242, 255 (8th Cir. 1969) (deeming a treble rise in the cost of the contract as outside the scope of the contract).

Petition at 42b-43b. *Accord* J. Andrew Jackson & Steven A. Alerding, *Expanding Contracting Opportunities Without Competition*, 26 PUB. CONT. L.J. 205, 206-07 (1997) (noting that, while examining the magnitude of any changes in the type, duration, and costs associated with the contract work is appropriate in considering whether a change is a cardinal change, the deciding issue is whether the modification is of a nature that potential offerors could reasonably have anticipated under the changes clause). In short, "*no rule of thumb exists to measure what constitutes a cardinal change.*" *Miller Elevator Co. v. United States*, 30 Fed. Cl. 662, 677 (emphasis added), *appeal dismissed*, 36 F.3d 1111 (Fed. Cir. 1994).

E. The Court of Appeals Failed to Apply Common Law Concepts of Good Faith in Deciding Whether the Asbestos Removal Fell Within the Original Scope of the Contract

The issue of whether a modification to a contract rises to the level of a cardinal change arises in two separate but related contexts. First, a modification made by the Government may bear such a tangential relationship to the original terms of the contract and intent of the parties as to rise to the level of a contract breach. Second, a government modification may be acceptable to the contractor but can still represent a cardinal change if it "change[s] the contract enough to circumvent the statutory requirement of competition." Petition at 12a

(citing *AT&T Communications, Inc. v. WilTel, Inc.*, 1 F.3d 1201, 1205 (Fed. Cir. 1993)).

Both the trial court and the Court of Appeals characterized a cardinal change as "a drastic modification beyond the scope of the contract." *See* Petition at 12a, 42b. The Court of Appeals failed, however, to apply this standard properly to the facts of the case and *sub silentio* disregarded the factual findings of the trial court.

The trial court focused on the scope of the contract as reflected by the expectations of the parties. To that end, the trial court paid close attention to the testimony of both the contracting officer and the other government witnesses, all of whom stated that the contract was intended to cover removal of all asbestos at the site:

> This Court notes, with interest, that while defendant strenuously argues that the Corps contract had not contemplated the complete abatement of all asbestos at the Raco site, *all* of defendant's witnesses testified to the contrary.

Petition at 27b n.24 (citations omitted) (emphasis in original).

The focus of the trial court was proper not only for purposes of determining whether such complete abatement rose to the level of a cardinal change, but also for examining whether the termination by the Government was made in good faith as defined by the common law. Under the common law, where one party has reserved a discretionary right under a contract, the exercise of that discretion is limited by the implied covenant of good faith and fair dealing and is bounded by the expectations of the parties. As one current Justice of this Court noted, while serving on the New Hampshire Supreme Court:

> [U]nder an agreement that appears by word or silence to invest one party with a degree of discretion in

> performance sufficient to deprive another party of a substantial proportion of the agreement's value, the parties' intent to be bound by an enforceable contract raises an implied obligation of good faith to observe reasonable limits in exercising that discretion, consistent with the parties' purpose or purposes in contracting.

Centronics Corp. v. Genicom Corp., 562 A.2d 187, 193 (N.H. 1989) (Souter, J.).[2] The issue then becomes whether a party's exercise of discretion violates the limits set by the intent of the parties.

The discretion referred to is discretion created within the terms of the contract, not discretion afforded to a party by virtue of its independent status as a government entity. Under the common law of contracts:

> A [party that possesses some measure of discretion under a contract] has an interest in maintaining the full range of discretionary action as agreed, and often bargained for, calling upon judges and juries to refrain from second-guessing amounting to ad hoc regulation. By contrast, the other party has an interest, also often bargained for, in securing some measure of protection from abuses of discretion by his contract partner. *Focusing on a discretion-exercising party's reasons for action, finding liability only when a party acts for a reason given up when entering the contract freely, tends to hold a discretion-exercising party to its voluntary undertakings without engaging in second-guessing or hidden regulation.* It protects one party's justified expectations that the other will act for expectable reasons in the relevant business context. This approach preserves a reasonable scope for discretion,

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[2] Justice Souter also noted that the breadth of discretion afforded under the contract, if sufficiently large, "can also raise doubt about the parties' intent to be bound." *Id.*

> rooting the limits on discretion in the parties' agreement.

Steven J. Burton and Eric G. Andersen, CONTRACTUAL GOOD FAITH—FORMATION, PERFORMANCE, BREACH, ENFORCEMENT 58 (1995) (emphasis added).

The question thus becomes whether the Government abused its discretion by terminating the contract for a reason given up when it entered the contract. As the trial court found, the parties intended that the scope of the contract encompass the removal of all the asbestos on the demolition site. The Government entered the contract without knowing the exact quantity of asbestos to be abated, but still intended for the abatement of *all* asbestos on site. Petition at 4b-5b, 27b n.24. The Government thereby gave up the opportunity to definitize the amount of asbestos to be removed. The Government could have and should have known the full extent of asbestos prior to contracting, but instead gave up that right to terminate for this reason by contracting with Krygoski to locate, abate, and remove all the asbestos from the site. Petition at 6b. It entered into a contract with clauses providing for variations in estimated quantities and changes. *See* Petition at 9b. These facts support the trial court's finding that the Government's decision to terminate the contract based on the amount of asbestos contained at the site represents an abuse of contractual discretion and constitutes bad faith on the part of the government.

Instead of addressing this issue, the Court of Appeals adopted a standard of leniency toward the Government, to be used whenever a reasonable inference exists of proper motive supported by the facts. Not only is there no basis in contract law for such a legal proposition, but also the Court's factual findings, upon which it purports to rely for its conclusion, have no support in the record.

The Court of Appeals held that it would "avoid a finding of abused discretion when the facts support a

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reasonable inference that the contracting officer terminated for convenience in furtherance of statutory requirements for full and open competition."[3] Petition at 15a. The Court of Appeals then turned this "reasonable inference" into a *factual finding* that the contracting officer in this case "terminated the contract to preserve full and open competition. He decided to avoid any prospect of prejudice to other bidders." Petition at 17a.

This statement by the Court of Appeals completely overlooked the factual findings made by the trial court, upon which the Court of Appeals should have relied unless such findings were clearly erroneous. Petition at 5a (relying on *Cooper v. United States*, 827 F.2d 762, 763 (Fed. Cir. 1987) and *Milmark Servs., Inc. v. United States*, 731 F.2d 855, 857 (Fed. Cir. 1984)). Those

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[3] The Court of Appeals seriously overlooked the distinction between governmental discretion created by statute and discretion reserved under the terms of a contract. The Court of Appeals appears to have adopted the "any rational basis" test, which has its foundation not in contract law but agency law under the Administrative Procedure Act, 5 U.S.C. § 701 *et seq.* (1994). *See, e.g., Brotherhood of Ry. & Airline Clerks v. Burlington Northern Inc.*, 722 F.2d 380, 381 (8th Cir. 1983); *American Hosp. Ass'n v. Schweiker*, 721 F.2d 170, 175 (7th Cir. 1983), *cert. denied*, 466 U.S. 958 (1984) (both holding that agency conduct is arbitrary and capricious only when it lacks any rational basis).

The discretion granted under agency law, however, is created by the enabling statute. *See Heckler v. Chaney*, 470 U.S. 821, 834-35 (1985) (limits of discretion exist to the extent meaningful standards have been provided by Congress). But, in the contract, the discretion is created and limited by the terms of the contract to which the Government agreed. By relying on the former and ignoring the latter, the Court of Appeals disregarded the long-standing line of cases from this Court that place upon the Government the same obligations of a private party when it chooses to enter contracts. *See, e.g., United States v. Winstar Corp.*, 116 S. Ct. 2432, 2464-65 (1996) (Souter, J., for the plurality); *Lynch v. United States*, 292 U.S. 571, 579 (1934).

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findings were that the motivation behind the termination was not an interest in promoting competition, or a concern for whether the work fell within the original scope of the contract, but a simple application of an unwritten rule of thumb as to contract price. That rule of thumb was tied to the increase in the cost of the contract, without regard to whether the increase was or was not intended by the parties to fall within the scope of the contract. *See* Petition at 11b. In making this finding, the trial court relied on the testimony of the contracting officer himself, who said that: "In this case, the *whole* reason for the termination was a change in the neighborhood of $300,000 to a $400,000 contract. That constituted a cardinal change." *See* Petition at 44b (emphasis added).

The rule of thumb is clearly inconsistent with the intent of the parties as found by the trial court. The Government, by awarding the contract, gave up the right to terminate solely to get a better price for the work, so long as that work fell within the expectation of the parties to the contract.[4]

Cost is but *one* of several factors in determining whether a change exceeds the scope of the contract. Nevertheless, the Court of Appeals raised the possibility that any modification, however closely related to the work contemplated by the original contract, may require contract termination and re-procurement merely because of the expense involved in the change. Such a result is

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[4] "CICA [the Competition in Contracting Act] does not require a new competition for a modification that is deemed to be within the scope of the original competed contract. This 'exception' to CICA's competition requirement is not really an exception at all: CICA does not require a new competition essentially because the modification -- or, more accurately, the potential for the modification -- was included with the original competition." Jackson & Alerding, *supra*, 26 PUB. CONT. L.J. at 206-07.

inconsistent with the established common law requirement of good faith, resulting in yet greater uncertainty among government contractors as to their true obligations under government contracts.

CONCLUSION

For the reasons stated above, this Court should grant the petition for a writ of certiorari.

Respectfully submitted,

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